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ECONOMIC THEORY IN AN ERA OF SOCIAL READJUSTMENT

By J. M. CLARK
The University of Chicago

I. *Introduction*

The place of economic theory in the coming generation will depend on what kind of theory is developed. Economic theory, like many another thing, will have whatever place it can make and hold for itself. There are two main ideals to be achieved. Economic theory should be actively relevant to the issues of its time and it should be based on a foundation of terms, conceptions, standards of measurement, and assumptions which is sufficiently realistic, comprehensive, and unbiased to furnish a common meeting ground for argument between advocates of all shades of conviction on practical issues. This is not an ideal of scholarly detachment, for that may lead to studies that are inconsequential or irrelevant to the issues of the day. It is an ideal of scientific impartiality, which is a very different thing.

In a sense, all economic thought is "theory," but I shall assume that we are talking of a central body of thought, different from the multitude of special studies into which we are constantly reaching out, and giving a general view of underlying forces at work in the economic system as a whole. It may lay down principles to be applied in the special fields of study, furnish tools of thought or methods to be used in them, or an orienting interpretation of the world in its economic aspects which puts these special studies in their place and helps to show their relation to each other. Surely there is place and need for such a central body of thought if economics is to have any organic unity, and to be in any sense an organized force.

By comparison with this outline of the place of theory, what do we find? In the more general treatises we find two bodies of principle, in more or less thought-tight compartments, and distinguished in various ways. On the one side stands a body of thought marked off as a deductive system, dealing with the mechanism of free exchange in a perfect market and accepting the valuations made by individuals in such a market as its final measure of economic quantities. It searches for laws governing levels of equilibrium in such markets, and in this broad sense is static.

In its view of human nature and of social-economic institutions it either assumes them to be static or tries to frame its static statements so as to admit, passively, the existence of dynamic facts but make no further changes in the static statements and hence make no *active analysis* of dynamic forces and changes in human nature and institutions. This has much the same effect as assuming them to be static.

I include here the type of theory which takes human choices as it finds them in the market, without asking if they are rational, impulsive, or what not. Some dynamic elements enter in; for instance, the idea of a progressive standard of living, and some cumulative forces are recognized, such as the fact that poverty breeds poverty and that high wages may perpetuate themselves through increased efficiency. This body of thought centers around the theory of value and distribution and it may be broadly characterized as "value economics" or "price economics." Its ultimate measure of wealth is utility as reported by some purchaser in making a purchase.

Alongside this body of thought is another of a different character. Sidgwick distinguishes it as the "art" of Political Economy and sets it apart from the "science," though he regards both as parts of economic theory. Here belongs John Stuart Mill's discussion of property and communism, of land tenures and of the sphere of government, and also the *Essay on Liberty*. Adam Smith's treatment of public expenditures falls in this division, also a large part of J. B. Clark's *Philosophy of Wealth*, and the writings of Veblen and Hobson. Here belongs also the discussion of practical problems which commonly fills the last half of our textbooks, so far as it embodies principles not developed in the first half. This second division of thought I shall call "social economics."

Both types of study have their strong and weak points. Social economics has often been treated unscientifically, but the subject-matter is capable of scientific treatment. The very caution that led Sidgwick (in order to keep clear of controversy, be it noted), to speak of it as "art" rather than as "science" also led him to treat it in a way that is unmistakably scientific. Social economics lacks quantitative definiteness and coherence, largely because there is no yardstick of social value. On the other hand, price economics has only a limited bearing on current issues, just because it does accept the yardstick of the market, hedged and

conditioned as this yardstick is by the very institutions which economic theory is expected to interpret to a critical and iconoclastic world. The materials of price economics are selected, not with reference to furnishing a rounded interpretation of the business system with reference to the movements that are afoot in the coming era of reconstruction, but with reference to their capacity for fitting into a quantitative, deductive scheme of thought—a logical "closed system." Its chief bearing on the problems of the day is to serve to show reformers what they cannot do, and even here it speaks with less uncompromising boldness than formerly.

The center of theoretical interest at present is in price economics. If theory is to take its proper place, the center of interest must be shifted and price economics must become a subordinate part of social economics.

II. Why Truth is Relative in Economic Theory

The place of economic generalization lies in the realm of things useful, somewhere between a futility and an impossibility. It is impossible to tell the whole truth about the world and if we insist on summing it up under a simple formula, the only ones that can be one hundred per cent true are in the form: "Whatever is, is," a proposition whose futility may be camouflaged but not cured. For example, our old friend, the "economic man," is becoming very self-conscious and bafflingly noncommittal. Instead of introducing himself to his readers with his old-time freedom and confidence, he says: "I may behave one way and I may behave another, but what is that to you? You must take my choices as you find them: I choose as I choose and that is all you really need to know." The poor thing has been told that his psychology is all wrong, and he is gamely trying to get on without any and still perform as many as possible of his accustomed tasks. On the other hand, human behavior in economic life is so many-sided that a letter-perfect description of it, beside being unattainable, would be just as unwieldy as the uninterpreted world itself.

Somewhere between this futility and this impossibility lie the really useful statements of principle, those which are significantly true. Most generalizations are true, in some degree: likewise their opposites are true in some degree. But some are trivial, and some, depending on the state of the popular mind, involve no doubtful issues.

Among those that are really significant, some are significant

for one purpose, some for another. A careful thinker always wants to know for what purpose a definition is to be used before he will admit it in an argument. Marshall, for instance, admits that price does not measure marginal utility because some are rich and some are poor, but says there are many problems for which this makes no difference, because these problems do not involve a redistribution of wealth. On the other hand, I know a jurist who seems to think that the way to settle the question of public utility valuations is to get the economists to define "value" in the abstract, and then let the courts make what use they will of this definition. Perhaps tomorrow—*mañana* or in the millennium—we shall be able to frame abstract definitions and generalizations that shall be proof against misuse, but in the past they have mostly been framed with reference to particular errors or evils which they might serve to combat. This is obviously true of the myths and slogans that animate fighting parties, but it is no less true of the most carefully qualified abstractions. The qualifications recognize passively the existence of facts and forces which the abstraction does not actively interpret. For that reason new issues must bring forth new selections of significant material embodied in new myths, new fighting slogans, and new abstractions. It is this which determines the range of study in the "social science of business."

Indeed, the most one-sided parts of economic theory are not the parts that deal consciously with the question whether private enterprise is better than public enterprise in any given case, but rather the parts where they feel themselves to be abstractly and impartially describing the economic system "as it is." For here they are not on their guard as to the use or abuse that may be made of their doctrines. One of the best examples of this unconscious attitude may be found in Smart's "Second Thoughts of an Economist" where he says:¹

"What I, for my part, found in Political Economy was a science whose main object was not defence of any particular system, but explanation of how men, consciously and unconsciously, work into one another's hands, and get and give each his daily bread. I saw it analyzing what we do in the every-day life of making an income and spending it; gathering up facts into categories and generalizations; drawing deductions of what men in general will do in the future from observation of what they have done in the past. All this seemed to me as impersonal as anatomy, as the writing of history, as the observation of the tides—and as necessary."

¹ Page 5.

In other words, political economy does not defend the existing system but it selects for explanation the elements of coöperation in it, which are the elements that everybody approves of. The Austrian theory, which Smart presents, is relevant to these good elements in the existing system, and it is not *positively and constructively* relevant to any other side of the case. It is this highly selective and highly partial theory which Smart seems to have found as impersonal as anatomy and it does credit to his saving sense of relevance to the needs of humanity that he felt something lacking in this theory and was moved to step outside of its limitations in his last book. On the other hand, a writer like Veblen, who also thinks that his analysis of the facts of the existing system is as impersonal as anatomy, concentrates his attention on a different set of aspects and forces in the industrial world, and gets a result of a very different color.

Each generation of economists succeeds to a new assortment of practical problems to which its doctrines are to be applied. Let a man start with early mediaeval ideas of trade (to which one sometimes sees a certain tendency to revert) holding that one man's gain is *prima facie* another's loss; that the exaction of the best possible bargain (even though it be the equating point of supply and demand) is obviously evil, and that whatever benefit can come of private business must be sought, not because of men's freedom to seek their own interests but in spite of it, through the direct and omnipresent intervention of church, government, or gild. Let him also feel the hampering effects and see the abuses of such a system of control.

Now let such a person become aware for the first time of the wonder of tolerable, though unintentional coöperation in which the frankest selfishness yields surprisingly decent results through the efficient but unplanned organization that the exchange system carries with it. Let him note the genuine service rendered by the price that equates supply and demand, by noting its superiority to those crude attempts at regulation which are the only ones he knows. Let him grasp the element of mutual aid running through exchange and see its organizing possibilities. Let him contrast these with the crippling effects of those crude attempts at interference which will inevitably furnish his standard of comparison and therefore, unconsciously, will represent the zero point from which he measures the plus and minus quantities of social benefit and social cost.

Let him be gifted with a mind of interpretative force, and in what terms will he frame his interpretation? What will be the dominant abstractions of his system? Obviously, those which embody the facts that he has to present to an unseeing world. The validity of price as an economic organizing force is his contribution, not its imperfections. *The Wealth of Nations* was such a study. The worst abuses of the time were those of local and national regulation of industry, and the powers of individualism were tugging at the leash with no chance to show what they would do or how far they would go when they were set free. Adam Smith's entire philosophy was relevant to this situation in that it promoted individualism more strongly than any economist would do at the present day, when individualism has shown us what it will do for good and for harm and where it needs to be supplemented and where it needs to be restrained.

The old-fashioned economic man is one of the abstractions which express this particular side of the truth, though with an absoluteness not found in real life. It is a true conception as over against the errors of the Mercantilist theory, and it is equally true (in that it contains truth) as over against present-day criticisms of the purely negative sort that would sweep away all the standing body of theory and put in its place no equivalent, merely because the psychological basis of utility theory is at fault. The statement that value has nothing to do with utility is an error, and the arguments in support of it, drawn from the high value of diamonds and the low value of coal and water, are fallacious. As over against such a doctrine the conception of marginal utility, as the key to the relation between prices and wants, embodies a vital and important truth. But it does not embody all we need to know of the relation of wants to prices. Taken as a statement of the way in which consumption is guided, it is inadequate, and therefore any doctrine which takes it as the ultimate and absolute law of consumption is false, as over against more constructive statements based on a better attested view of human nature, amending the general case for free exchange in definite directions and furnishing a basis for needed and practical measures of constructive reform.

But such a conception as the economic man becomes more formalized and crystallized with the passage of time, and structures of deduction are increased upon it, becoming more elaborate and more brittle, long after its chief active purpose has been attained

in the freeing of trade from mercantilist shackles, and it has subsided into the more passive rôle of furnishing a *prima facie* case in favor of the competitive order as over against projects of revolution or fundamental reform. Meanwhile the new generations are arising.

What is their vision? The marvel of spontaneous coöperation is no marvel to them. Their textbooks have presented them with its concentrated essence in a purity more or less frankly unreal. This furnishes their intellectual point of departure. The direction in which the world about them departs from this formula is toward apparent variations from type, which fail to produce the expected efficiency and instead cause waste and social loss rather than pure mutual gain in the process of free exchange. The older student was interested primarily in the fact that prices do reach an approximate equilibrium. The newer is interested in the bad quality of housing accommodations as a disastrous and unnecessary phase of *laissez faire*; in the effects of seasonal fluctuations of industry as an imperfectly compensated cost of production; in the wastes of competition and in methods of diminishing them.

The older theorist had written down as his "balance carried forward" a theory of the pernicious effects of free enterprise, and such tolerably good tendencies as he discovered were clear gain. The modern theorist carries forward a theory of one hundred per cent efficiency for competitive institutions and is alert to all shortages, for they appear as a clear deficit. The conceptions adopted by the one embody the elements responsible for the harmonies he finds; those demanded by his present-day successor must embody also the qualities responsible for the many and various disharmonies, and hence must be at once less simple and universal and more realistic and particular.

III. Some Tools of Social Economics

The central problem of social economics is the organization of the economic forces of society to get and to do the things that are wanted. Price is of interest, not so much for its own sake as in view of the part it plays in this work of organization. Value economics is primarily interested in the determining causes of price; social economics is primarily interested in its function as an organizing agency. Since value economics analyzes this function *so far as market values may be taken as a gauge of social purposes and desires*, social economics must make its contribution by in-

terpreting the social values which market value distorts or ignores, and the resulting discrepancies between market value and a more comprehensive view of social values, between competitive efficiency, national efficiency, and perhaps world efficiency.

Some maintain that the study of these discrepancies is a matter of ethics and not economics, largely because it seems to involve sitting in judgment on individuals' wants and criticising the system of gratification because the wants that animate it are bad. But there is a great deal more to the matter than that. For example, in some places an owner of real estate can secure an "easement of light and air" protecting him against what would otherwise be an uncompensated damage to his property when someone puts up a high building on the adjoining lot. This damage to property is an economic fact where the owner is so protected, but where the law does not make such protection possible, shall we be told that this same damage is not an economic fact at all, but purely an ethical one? Such an attitude would stultify any attempt to make economics fully and actively relevant to social changes. It could not even report as a descriptive fact the existence of the value which the old system sacrificed and which reformers wanted to protect, until *after* the reformers had succeeded in protecting it. Such a report would be fatally biased by leaving out elements unfavorable to the existing order.

What are some of the conceptions that furnish tools for the study of social economics? Time permits only the bare mention of a few and one of the most far-reaching has just been mentioned. It is the conception of the inappropriables: of costs and services that are not fully compensated because our legal system does not or cannot surround them with the rights and protection that go with full private property. It may not be the part of economic science to assume to set a quantitative value on these things, but it is a very important part of its task to study them as economic facts which furnish the raw material for social valuations different from the valuations of the market.

Another important principle is the principle of alternatives, which states that values and costs must always be interpreted with reference to the range of alternatives that are open. This furnishes another reason why social valuations and individual valuations differ, because the range of alternatives open to society is different from that open to individuals. The individual may escape from costs that society has to bear, or *vice versa*; the indi-

vidual may choose under the pinch of want or under bad bargaining conditions, when it is not socially necessary that he should be confined to such a stern choice of evils.

Another principle is that economic effort is not merely guided by personal choices as they appear in the market, but itself guides those choices. The study of the institution of "free choice" from the educative point of view opens up an endless vista of fruitful study. The study of knowledge as a productive asset opens up another vista. Knowledge is different from material means of production, for it is inexhaustible, is generally not fully appropriable, and does not conform to the formula of marginal productivity as that is applied to the material forms of capital. Industrial morale is another tremendously important social-economic asset whose laws are largely unformulated. Then there is the possibility of objective standards of value furnished by science. Science can never dictate to humanity the choice of the ultimate ends of life, either individual or social, but it may determine objectively the value of means to ends where the ends are known, and it may serve, in this field, to revise individual values as they are expressed in a free market. Our present system of industrial priorities is a system of non-market values, recording judgment of the objective importance of things as means to winning the war or guaranteeing the absolute necessities of life to the peoples of the world. But apart from war or worldwide food shortage, the health values can be measured objectively by the medical profession, and it is a fair assumption that most people want health.

Social economics must try to distinguish things that are due to our existing institutions from things that are independent of them. To do this it is necessary to know something about institutions other than our own, including possible experiments that may be as yet untried. Thus the social economics of the existing order cannot be confined to a study of the existing order itself. For example, some form of accounting involving estimates of marginal productivity is necessary to efficient organization under any system, socialist or otherwise. But the exchange-value measure of productivity depends on private enterprise and the use of this gauge of productivity as the standard for distributing rewards depends on private enterprise and competition.

Finally, social economics should know something of social purposes, if it is to report on the effects of business in furthering or

thwarting those purposes and is not to confine itself to such purposes as are expressed *via* individual demands in a free market. We have lately had a stupendous object-lesson in the contrast between the economy best fitted to serve the dominant purposes of war and the economy naturally adopted by peaceable and democratic nations. This is only one example of an organic social purpose the promotion of which is not guaranteed by the type of efficiency that private enterprise promotes. Because it has not been oriented by a realistic and independent study of social purposes economic theory has seemed to be directed toward one limited set of social purposes, often stigmatized as materialistic, commercial and unworthy.

IV. *Certain Stumblingblocks*

So much for the positive side: the principles to be followed. There are certain stumblingblocks in the traditional methods of theory: certain things to be avoided. One lies in the definition of wealth as consisting in objects of desire, limited in supply, appropriable and exchangeable. The danger lies in assuming that these characteristics are coextensive, and is illustrated by the fact that writers, in showing what they mean by things that are not appropriated, regularly cite examples of free goods. This directs attention away from those inappropriables which are not free goods and around which so much of economic policy centers.

Another thing of more than doubtful value is the tendency to treat human values and costs in the language of accounting. This tempts one to forget that costs in accounting are measured from an absolute base line set by the maintenance of the assets of the business intact. There is no such base line in human accounting, and the deficit economy is a human reality which the idea of a consumer's surplus fails to report. From this point of view the whole conception of "psychic income" is dangerous. Then there is the fact that the study of utility seems to be oriented by the question: "To what is value equal?" rather than by the broader question: "How does value function in relation to human wants?" Another stumblingblock lies in treating social efficiency as a sum of individual efficiencies. This is a mistaken outgrowth of a very true idea: namely, the idea that things serve society in proportion as they serve the individuals in society. The logical error is precisely the same as would be involved in arguing that a railroad line is well located because none of the locomotive engineers find it

worth while to run their engines off the rails in search of a better location. A final stumblingblock is the attempt to keep economics pure by avoiding the subjects of sociology, jurisprudence, ethics, psychology, and what not. This defeats its own end, if it goes so far that when the economist needs an assumption from these fields he manufactures it himself, for he is likely to produce an assumption that involves bad psychology, or bad jurisprudence, or bad sociology. He needs to have sufficiently close relations to these fields to borrow his assumptions from competent specialists in order that his own work may be in his own field of special competence.

V. *Conclusions*

If theory is moulded on the lines suggested, what will it look like? It will not be a complete set of finished doctrines, nor of quantitative laws, and will contain more qualitative analysis than quantitative. It will spend so much time in establishing its assumptions on a realistic basis that there will be less to spend in elaborating the minutiae of the laws that may be deduced from them. It will furnish the student with tools of thought rather than with the finished product; with knowledge of the general features of the institutions he is studying; and with principles of a widely varying sort, embodying many ways in which business affects human desires, directly and indirectly. Possibly its study of methods may go so far as to set up standards of scientific procedure in a field where work is now regarded as not genuinely scientific. Sometime there may be a recognized economic methodology which may occupy a truly central place in economic thought.